

INVESTING AT HOME OR SAVING: A NOTE ON CHILE'S FINANCIAL FLOWS

¿INVERTIR EN CASA O AHORRAR EN EL EXTRANJERO?: UNA NOTA SOBRE LOS FLUJOS FINANCIEROS DE CHILE

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ABSTRACT

In this paper, we analyze the financial flow of funds between Chile and its trade and investment partners using balance of payments data for Chile and for a set of comparable economies. We show that the inbound and outbound financial flows have been consistently balanced by long term funding, at least up to the year 2020, Chile showing a positive position on foreign portfolio investments grossly matched by a negative position on foreign direct investments. However, we document a systematic deficit in terms of returns and yields: inbound financing is more remunerative than outbound financing. The imbalance is especially salient as per the direct investments. The last part of the paper is devoted to a somewhat open discussion on whether a better matching of funds could be effected to the overall advantage of Chile, in what is called the 'inwardization' of domestic finance. Some economic policy considerations result.

RESUMEN

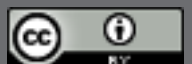
En este paper, analizamos los flujos de fondos entre Chile y sus socios comerciales y de inversión, utilizando datos de la balanza de pagos de Chile y de un conjunto de economías comparables. Mostramos que los flujos financieros entrantes y salientes se han equilibrado sistemáticamente a largo plazo, al menos hasta el año 2020, mostrando que Chile tiene posición positiva en las inversiones de cartera que se corresponde más o menos con una posición negativa en las inversiones directas. Sin embargo, documentamos un déficit sistemático en términos de rendimientos y rentabilidades: la financiación entrante es más remunerativa que la saliente. El desequilibrio es especialmente notable en lo que respecta a las inversiones directas. La última parte del documento se dedica a un debate algo abierto basado en la cuestión de si se podría realizar una mejor adaptación de los fondos en beneficio general de Chile, en lo que se denomina la "internalización" de la finanza doméstica. De ello se derivan algunas consideraciones de política económica.

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The British used to humorously praise their country – this was before the Brexit – for its large economic openness to capital, goods and people: “*We provide the playing field, the international players come and play*”. Chile largely replicates this playground strategy, made possible by the generally excellent quality of its institutional framework. The leaders of the Concertación have leveraged this capital of trust, which comes a long way in Chile's history and have reinforced it by some institutional and economic mechanisms that are now part of the social consensus. It helped them in pursuing the economic and financial opening initiated during the second period of the military regime. This has allowed a large and rapid wave of investment, with imported skills that the country lacked at the time.

Thus, customs barriers were kept low, an extensive set of preferential trade agreements put in place and imports of manufactured goods were encouraged to the advantage of Chilean consumers. Foreign capital penetrated, at times massively, many sectors of activity: mining, utilities (energy, communication, transport infrastructure, water), the financial sector (banks, insurance and asset management), and agribusiness (milk, salmon...). On the other hand, some Chilean groups, notably Falabella, Latam or Grupo Quiñenco, successfully expanded internationally, especially in Latin America. During the period, a large amount of private sector savings were built up and, in the case of households, invested mainly in pension funds following the pension reform of the early 1980s. A financial market has emerged in the field of asset management. For reasons of risk diversification and profitability, but also due to the poor density of eligible financial assets in the country, these savings have been largely invested abroad, up to a proportion of more than half today. Both the state and external accounts have remained broadly balanced, due to copper revenues and rigorous management in public finance, notably the floating exchange rate regime and the balance budget rule adopted respectively in 1999 and 2005. See Berstein Marcel (2018), Frankel (2013). The public debt, contained at less than 25% of GDP before the

double crisis of Covid and the *retiros*¹, has remained largely financed (at about 80% until 2020²) by local savings, allowing external funding of such indebtedness to remain low, thus reinforcing the autonomy of Chilean monetary policy.

These advantages are generally credited to have fostered Chilean growth at least up to the middle of the second decade of the century. Questions are raised nowadays whether this type of openness have gone too far and be part of the explanation for the slackening of growth in the country since 2015. These complex questions go beyond the scope of this paper, which limits itself to examining the external financial flows of the Chilean economy a descriptive analysis. We enrich it, though, by a comparison with a panel of countries showing similar characteristics one way or another. What the paper puts in evidence is a general bias in favor of investing domestic savings abroad, together with favoring inbound international investment. We document that the cross flows of funds might not provide the optimal return on aggregate (financial + real) investment for the country.

This paper, which does not bear on industrial policy, can be seen as an add-on to an extensive literature on the constraints brought by the primary resources export-led nature of the Chilean economy. It was feared in the early 2000's that the high exposure to copper exports, together with the generally favorable terms of trade and high volatility that it implies, would hamper the capacity of the economy to grow a substantial industrial base in tradable goods, the so-called Dutch disease or cruse of resources effect. There is now a

1. In the wake of the Covid crisis, a discretionary withdrawal (“*retiro*”) from the pension funds, up to 10% of each of its individual amount, has been allowed. It escalated into a general request for more withdrawals (two further ones occurred) as well as generous distribution to the public by the government with the view of staving off the leakage from the retirement funds. All in all, \$50 bn have been draught from the pension funds and a further \$25 bn distributed by the government over the years 2020 y 2021. This adds up to 25% of the 2021 estimated GDP, admittedly the largest stimulus package worldwide.

2. It increased at 35% in 2021.

significant consensus among the economists that the floating exchange rate regime and the balance budget rule have played a strong neutralizing role against this effect. See for instance Fornero Gatty-Sangama (2019); De Gregorio Labbé (2011); Caputoa Valdés (2016); Fornero Kirchner and Yany, 2016. A dissenting view can be found in Madrid-Aris Villena (2005) or Ahumada (2019). Another brand of research puts the emphasis on intrinsic difficulties, pertaining to economies of scale and scope, that Chile may have to build such a base, making the case for sticking to the natural resources sector. See González, Larraín y Perelló (2020). But we find very little amount of research specifically focused on financial flows and their profitability, apart within the extensive study performed by OECD (2016) on the inclusion of Chile in the global value chains, which examines to role of foreign direct investment (FDI) in Chile and abroad. See also Schwellnus (2010) on this topic.

The paper is organized in the following way. In part I, comparison is made in terms of international financial flows and investment positions, focusing on direct and portfolio investments. In part II, we examine the profitability of such flows, again from an international perspective. Part III makes a more precise comparison between Chile and New Zealand, two countries of comparable size in terms of GDP and which present strong analogies in terms of openness to foreign capital and export structure. We finally venture in Part IV some preliminary propositions that the descriptive approach may suggest in terms of public policy.

The comparison sample includes three Latin American countries, Mexico, Brazil and Argentina (LA3), for obvious geographical reasons, although we could have included in the panel Peru which is growing a strong mining and agricultural sector. We retain three developed countries with strong institutions and a high level of commodity exports, Australia, Norway and New Zealand (EX3). For the sake of giving a reference, four developed advanced countries are included in the panel, the United Kingdom, Denmark, France and

Japan. The currency unit is the dollar throughout this paper. Most of the comparison is made for the year 2019, although data are available for 2020 and part of 2021, as this year is not affected by the Covid crisis.

1. TRADE OPENNESS VS. FINANCIAL OPENNESS

Using BC and IMF statistics, we build two indexes. The first one characterizes the importance of trade in goods and services, and for this purpose it classically relates the sum of exports and imports to the country's GDP. The second does the same, but in the financial sector, for so-called "direct" investments, a word that designates equity and debt investments that a foreign group provides or controls in the country for 'strategic' purposes – this is an import of capital – or that a Chilean groups does abroad – this is an export of capital. Veolia-Suez's control of Aguas Andinas illustrates the import side, and Falabella's subsidiary in Colombia the export side. As with goods and services, the index sums the imports and exports of these flows in relation to GDP. It measures the intensity of the country's openness to FDI. In a subsequent section, a similar index is presented, but for portfolio investment flows, a word which characterizes savings investments without industrial purposes.

Chile: trade openness as compared with other countries

With a trade openness index of 57%, we see (Table 1) that Chile is in line with the three commodity exporting countries of our panel (Australia stands at 46%, New Zealand at 54%). Norway, a very large exporter of oil as a proportion of its GDP, has a higher trade openness, at 71%.

Chile has a much higher ratio than two of the large Latin American countries, Argentina and Brazil, at 32% and 28% respectively, although part of this difference is due to the smaller size of Chile, given the usual inverse relationship between size and trade openness. Mexico maintains a higher level of trade openness (78%), given

its strong industrial integration with its large northern neighbor. The UK economy is strong in services, and especially in financial services, but less so in trade of goods. Its index is only 39% of GDP, well below the more integrated European countries due to the creation of the euro zone, including France, at 66%.

Table 1. Trade openness and openness to foreign direct investment

(in percent of GDP, 2019)	Commercial Openness index	Direct Investment			
		Openness index	Assets	Liabilities	Net
Argentina	32%	25%	9%	16%	-6%
Brazil	28%	69%	22%	47%	-24%
Mexico	78%	67%	18%	49%	-31%
AL3	46%	63%	19%	43%	-24%
Australia	46%	100%	44%	55%	-11%
New Zealand	54%	52%	11%	41%	-30%
Norway	71%	117%	63%	54%	9%
EX3 Countries	57%	90%	39%	50%	-11%
Chile	57%	149%	51%	98%	-46%
Denmark	111%	144%	88%	56%	32%
France	66%	115%	68%	47%	21%
Japan	35%	42%	36%	6%	30%
UK	39%	164%	80%	83%	-3%

Source: BC, IMF Balance of Payments and International Investment Position; AL3, EX3 = arithmetic mean

Chile's financial openness to FDI is very high

As showed in Table 1, col 1 of the figures, there is however a large difference for Chile as per its FDI openness index, which adds up the stocks of imported and exported direct capital. It is the highest in the panel (149%). Only Great Britain exceeds it, because of the large capital flows generated by the banking and financial activity of the City of London. The index is much lower for LA3: 25% for Argentina, 67% for Mexico and 69% for Brazil. The EX3 group is also much lower, at 90% on average, with New Zealand at 52%.

If we look at gross investment in the country, again in stock terms, the share of capital held by foreign

groups in Chile as a proportion of GDP is 98%³, again the highest in the sample. The three Latin American countries stand only at 43%. The EX3 group averages at 50%, half as much. Only the United Kingdom is in line with Chile, which again is related to the many foreign financial groups using their London location to expand into the rest of Europe. France (47%) is less open to foreign capital. Japan (6%) is notably autarkic from a financial point of view.

3. This ratio is obviously not the share of local firms held by foreign interests. See the ENIA survey made by INE to have a view on shareholding structure in Chile by sector. In the study of 2015, OECD (2016) estimates that 35% of FDI stocks and 50% of flows is done in mining and quarrying..

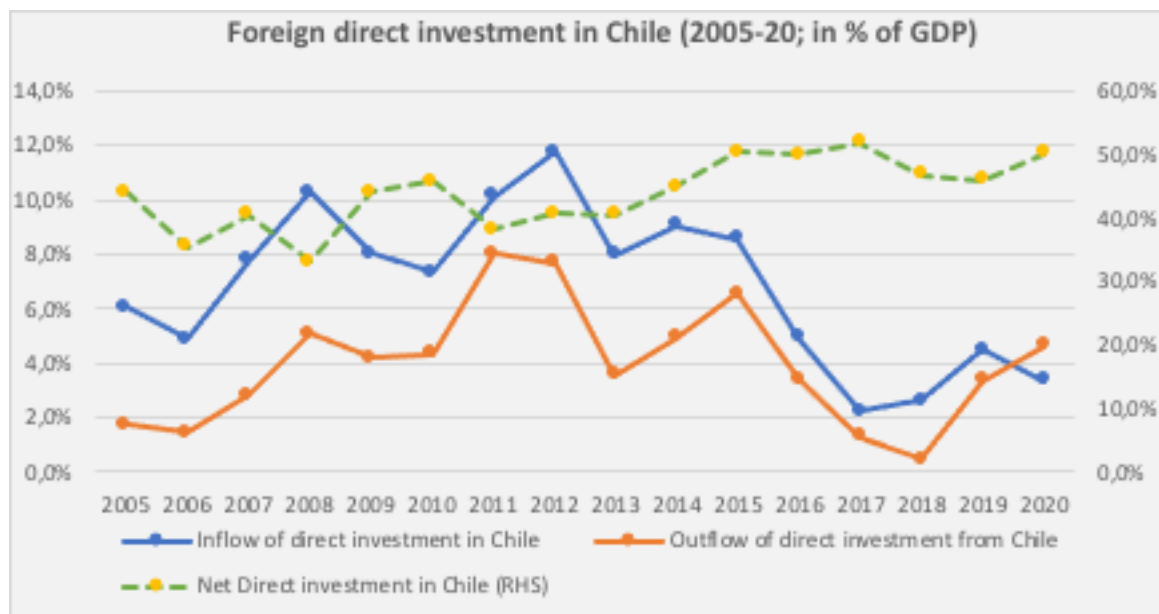
All in all, Chile is the largest net importer of capital (46% of GDP, col. 4) in terms of FDI, much higher than AL3 or EX3 countries.

Chile as a platform to Latin America

While Chile is very open to investment by foreign companies, it also makes a lot of FDI abroad. The stock of non-domestic capital held by resident companies in Chile amounts to 51% of GDP.

It is likely, though difficult to document for lack of specific statistics, that much of the capital exported takes its origin in foreign groups based in Chile, as it is the case for mining companies, and that this investment is focused on Latin America (Ministerio de Relaciones Exteriores, 2020). This illustrates the platform strategy adopted by the country. A clue of this phenomenon is given in Figure 1, which evidences the strong correlation between FDI inflows (blue line) and outflows (orange line).

Figure 1. Foreign Direct Investment in Chile (2005-20)



This chart also shows the size of these flows in relation to the Chilean economy. At the peak of direct capital inflows, in 2012, the import flow reached 11.7% of GDP (or \$31.7 bn at the time) and the inflow an amount close to 8% of GDP. Between 2010 and 2013, these four points of GDP can be related to a growth of 12.6% of national income.

Thereafter, these gross and net capital inflows fell sharply. The inflow is only 4.5% of GDP in 2019. This slowdown, which may be deemed natural given that large investments have already been made in infrastructure, utilities and, to a large extent, in the mining sector, partly correlates with the slowdown in the Chilean growth since 2015 (be it because of lack of opportunities on the demand side or because of a supply side dearth of capital from abroad). The green dotted line in Figure 1 (right-hand scale) shows that the stock of direct capital held by foreigners in Chile has reached a ceiling of around 50% of GDP. It is too early to say whether the crossover of the capital inflow and outflow curves in 2021 is partly the result of the political uncertainty opened by the social unrest of October 2019 and its ensuing uncertainty for investors. Indeed, the figures show both a pickup in net capital inflows (by \$5.2 bn) in the first half of 2021, but again a net outflow of \$1.7 bn in 2021.Q3.

The role of debt flows in the circulation of capital

An important point refers to the funding of these FDIs: debt or equity? Table 2 shows that up to 20% of the capital imported as direct investment takes the form of debt (this is the stock and not the annual flow), in loans to the Chilean subsidiary from the parent company or from its subsidiaries abroad. However, the debt leverage ratio is close for outbound and inbound investments, which may suggest the absence of large tax avoidance strategies, when low indebtedness is contracted by Chilean subsidiaries abroad and more by subsidiaries located in Chile for profit transfer purposes⁴.

Table 2. Financial composition of foreign direct investment

<i>Direct investment (in % of GDP; 2019)</i>	Chile
Assets	51%
Equity and investment fund shares	44%
Debt instruments	8%
Liabilities	98%
Equity and investment fund shares	77%
Debt instruments	20%

Chile is, on the contrary, a major exporter of capital through portfolio investment

We now look at portfolio investments, those made for financial investment purposes. These are purchases by Chilean resident entities of stocks or bonds (for the export of capital) and purchases by foreigners of Chilean stocks and bonds (for the import). Non-bank financial institutions, i.e., insurance companies, mutual funds and pension funds, are the main players in the export of capital for portfolio investment purposes. Sovereign funds managed by the central government (FSP, FEES, etc.) are important buyers of debt securities. Unsurprisingly, the bulk of such investments is done by pension funds, AFP and APV. Out of a total of 66% of GDP of such funds, they represent an amount of 41%. These funds conspicuously prefer to invest in equity rather than in debt securities.

With an openness to portfolio investment of 104 percent (column 1 of Table 3), Chile is clearly below the most advanced countries, which have larger domestic capital markets and a higher national wealth-to-income ratio. But this is not the case with Latin American countries: the index for LA3 is only 37%. The EX3 group is higher in terms of the openness index, 166% for Australia and 129% for New Zealand. Norway, which has little opportunity to recycle the huge, accumulated oil rent into the country, peaks at 443% via the investments

4. It may therefore lead to infer that the income tax rate in Chile,

though higher than in other Latin American countries, has no perceivable consequences on potential tax transfers.

of its sovereign wealth fund. The difference between these countries and Chile is essentially due to fewer opportunities for portfolio investment in Chile, i.e., in the form of listed assets, compared with the three countries mentioned: the rate of capital inflow is 38%, whereas it is 100% for Australia and Norway, and 74% for New Zealand.

Table 3. Openness to portfolio investment

(in percent of GDP, 2019)	Portfolio Investment			
	Openness index	Assets	Liabilities	Net
Argentina	31%	15%	16%	-1%
Brazil	33%	3%	30%	-28%
Mexico	46%	5%	41%	-36%
AL3	37%	5%	32%	-27%
Australia	166%	65%	101%	-35%
New Zealand	129%	55%	74%	-19%
Norway	443%	343%	100%	243%
EX3 Countries	246%	154%	92%	63%
Chile	104%	66%	38%	28%
Denmark	306%	162%	144%	19%
France	249%	105%	145%	-40%
Japan	159%	88%	71%	18%
UK	291%	125%	165%	-40%

Source: BC, IMF Balance of Payments and International Investment Position; AL3, EX3 = arithmetic means

Similarly, public debt levels remained at a very low level of between 18% and 24% for these four countries until 2019, so that international financing of the state still results in low capital inflows.

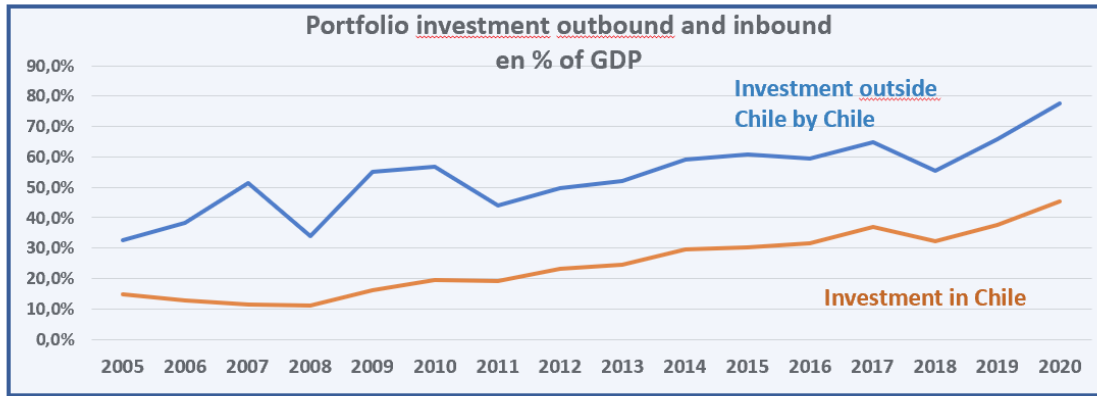
Netting export and import of portfolio investment, Chile is the only country to have a positive net position (28%), together with Denmark (19%) and Japan(18%). All other countries in the panel show a negative balance. As explained, it is due to its funded pension system and the small size of its domestic financial market.

Figure 2 shows the steady build-up in portfolio investment for Chile, with, after a fall in 2018, a sharp

acceleration in 2019 to 2021, mostly linked to the rise in international equity prices from 2020 and of the USD/CLP exchange rate.

As for inbound investment, and again, the difference between Chile and EX3 is essentially due to the scarcity of portfolio investment opportunities in Chile under the form of eligible assets: the ratio of capital inflow is 38%, whereas it is 100% for Australia and Norway, and 74% for New Zealand.

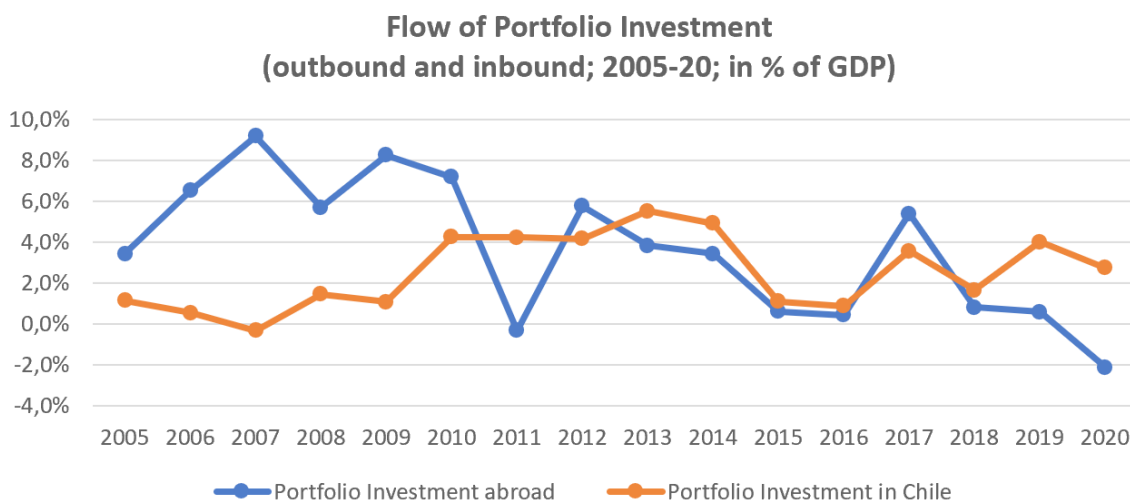
Figure 2. Portfolio investment outbound and inbound.
Chile



Analyzing now the flows of funds and not the gross positions (Figure 3), we see that from 2011 onwards there is an overall balance of inflows and outflows starting after the financial crisis of 2008-09, at around 2% of GDP. It means that the divergence between the gross positions has been built in the 10 first years of the 2000s. It is only in 2020, with the *retiros*⁵ that the outflows have fallen well below the inflows, the balance becoming clearly negative (-2.1% of GDP in 2020, after 0.6% of GDP in 2019). The year 2021 attenuates somewhat this imbalance, with a slew of foreign equity purchases by the AFPs.

5. See footnote 2.

Figure 3. Annual flows of portfolio investments, outbound and inbound. Chile



Source: BC, Chile Balance of Payments

Portfolio investments are mainly in equity for exports and in debt securities for imports

Chilean investment funds (publicly held and pension ones) invest heavily in equity, while inbound portfolio investment in Chile is largely the result of borrowing by private corporates and government (up to \$27 bn in 2019 for the latter). The proportions for the year 2019 are given in Table 4 below:

Table 4. Financial composition of portfolio investment

Portfolio investment (in % of GDP; 2019)	Chile
Assets	59%
Equity and investment fund shares	52%
Debt instruments	8%
Liabilities	38%
Equity and investment fund shares	8%
Debt instruments	29%

There is therefore a strong credit position in equity securities, and a debit position in debt securities, which will show accentuated if we consider the large borrowing abroad of the Chile government. Given

the higher return on equity than on bonds, this factor tends to benefit Chile’s income account in its external relations, with a positive leverage effect but with the accompanying financial risk attached to indebtedness. We will see in Part II that despite this advantage of debt leverage, Chile does not show a positive net financial investment income.

2. ANALYZING THE PROFITABILITY

Two approaches are used to characterize profitability. The first is a facial profitability that relates primary income to the associated stock of investment or to GDP, for both direct and portfolio investments; the second is a more financial approach that calculates the total rate of return (TRR) on investment, including capital gains and losses (see box). It should be noted, for that matter, that balance-of-payments accounting rules do not take into account capital gains or losses on debt securities. Similarly, the profit generated (in the case of direct investments) or the capital gain generated (in the case of portfolio investments) remains largely in the industrial holdings or in the investment funds,

respectively, without being repatriated to the country of origin of the investment⁶.

Box: Calculating the total return

If we call K_t the outstanding amount invested in year t , we have the following capital dynamics: $K_t = K_{t-1} - F_t + PV_t$, where F_t is the flow of dividends or interest from the capital and PV_t is the appreciation in value of that capital, whether due to price or exchange rate changes (the calculation is done in USD, but investments are often made in other currencies). In the balance of payments, equity securities are marked to market, while debt securities are valued at historical cost.

The return of the investment is therefore the sum of the capital gain and the cash flow, dividends or interest, that accrues to the investment in proportion of the capital of the previous year. The TRR is calculated as the ratio of such return to the capital at the end of the previous period. To average it over the period (2006-20), we calculate its geometric mean.

Knowing its external exposure, Chile receives low primary incomes

Table 5 shows the amount of the current account, the balance of trade in goods and services and the primary income decomposed into inflows, outflows and balance (in % of GDP and for the different countries). Primary income includes income from direct and portfolio investments, but also workers' remittances and other financial income (mainly trade credits). It is recalled that this primary income includes the profit retained in the country and not only the dividends or interest paid.

6. Also, accounting rules as per the balance of payments do not make the distinction between distribution and retained earnings in the investment funds.

Table 5. Primary income from and to the country, in % of GDP

Revenues in terms of GDP	Current account	Total Goods & Services (net)	Primary income (net)	Primary income credit	Primary income debit
Argentina	-0,8%	0,0%	-4,0%	1,4%	5,4%
Brazil	-3,5%	-0,5%	-3,0%	1,3%	4,4%
Mexico	-0,3%	-0,2%	-2,9%	1,1%	4,1%
AL3	-1,5%	-0,2%	-3,3%	1,3%	4,6%
Australia	0,6%	3,4%	-2,8%	3,6%	6,4%
New Zealand	-2,8%	0,1%	-2,7%	2,8%	5,6%
Norway	2,9%	1,5%	3,1%	10,8%	7,7%
EX3 Countries	0,2%	1,6%	-0,8%	5,7%	6,5%
Chile	-3,7%	-0,8%	-3,6%	3,9%	7,6%
Denmark	8,8%	7,4%	2,9%	8,9%	6,1%
France	-0,3%	-0,9%	2,5%	8,1%	5,6%
Japan	3,4%	-0,2%	3,8%	6,1%	2,2%
UK	-2,7%	-6,1%	-0,6%	9,7%	10,2%

Source: BC, IMF Balance of Payments and International Investment Position; AL3, EX3 = arithmetic mean

Chile pays abroad a primary income (last column of Table 5) equivalent to 7.6 percent of GDP, a percentage exceeded only by Norway and the United Kingdom in the sample. The primary income balance is strongly negative, at 3.9 percent of GDP, similar to the average balance for LA3 countries (-3.1 percent). The other countries have a positive balance, except for New Zealand, to which we will return later. It is this deficit that needs to be analyzed, since it may be either an index of low profitability in capital exports or of high profitability for foreign interests in Chile.

This is done in Table 6, which analyzes income flows, on the credit and debit side, for direct and portfolio investments, which are by far the most important items of the primary income line, although remittances is a growing item. We note that the balance is always clearly negative to Chile for FDI, whether measured as a percentage of GDP or as a return on capital employed. This is not surprising, given that foreign capital in Chile far exceeds Chilean capital abroad. More significantly, the nominal return on investment, i.e., in relation to the capital invested, is higher for investments made by foreigners in Chile. The capital gains

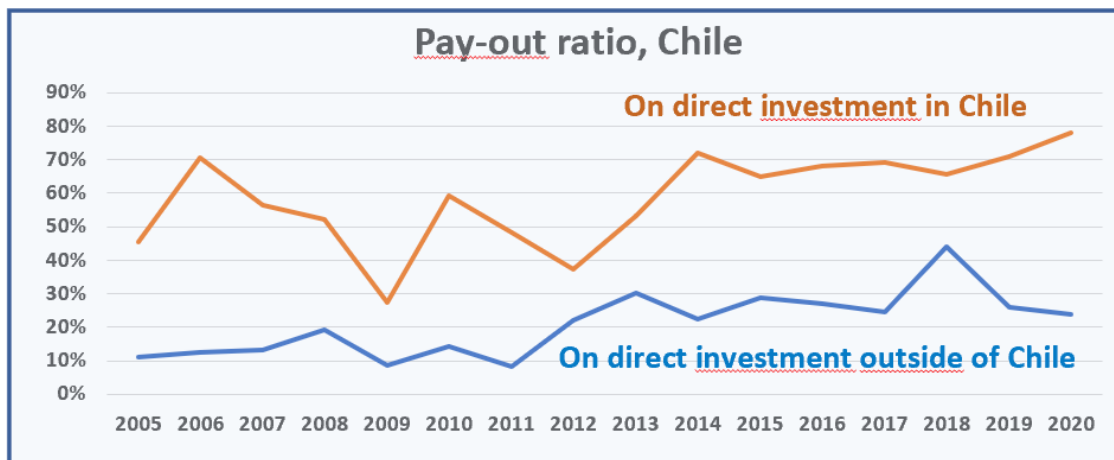
on such investments, which do not appear as income in the balance of payments, will be considered later in our analysis. For portfolio investments, we have the somewhat surprising result that foreigners in Chile are more profitable than Chilean investors abroad in terms of the capital invested, even though the latter are more likely to invest in equity, which is a priori more profitable.

Table 6. Income from and to Chile, direct and portfolio

2019; in %	Income to ...	
	Chile	Foreign Countries
In % of GDP		
Direct investment	1,9%	5,5%
Portfolio investment	1,6%	1,3%
Total	3,6%	6,8%
in % of assets		
Direct investment	3,8%	5,6%
Portfolio investment	2,5%	3,5%
Total	3,0%	5,0%

As mentioned above, the investment income above is the sum of the cash flows, i.e., dividends and interest, plus the profits reinvested in the country which do not show as an external flow of funds. Therefore, it is interesting to see whether the profits from FDI are reinvested or passed on to the investors. A payout ratio is therefore calculated as the ratio of dividends and interest to total income from FDI. This is shown in Figure 4.

Figure 4. Pay-out ratio on inbound and outbound direct investment, Chile



As shown, the payout ratio is much higher for investments in Chile than for those abroad. This may be a sign that investments in Latin America from Chile are at a less advanced stage of development and necessitate more retained earnings, although the ratio seem stuck at around a 20% level. On the same line of reasoning, the payout ratio for inbound investment is increasing over the period, which may indicate the growing maturity of investments in Chile, a large part of which, as we have seen, was made between 2005 and 2012. Such investments may have become more 'extractive'. Whatever the reason, in 2020, nearly 80% of Chilean profits before taxes and capital gains on foreign-held capital will return to foreign investors. (Part of these profits, to be noted, are profits that go back via Chile to foreign non-Chilean participations for their inter-

mediated investments in Latin America). Despite the sharp rise in Chilean payout in 2020, we do not see the continuation of this movement over the first half of 2021. It is difficult therefore to validate, based on balance of payments statistics, a reaction of fear in the face of a more uncertain business climate since 2019.

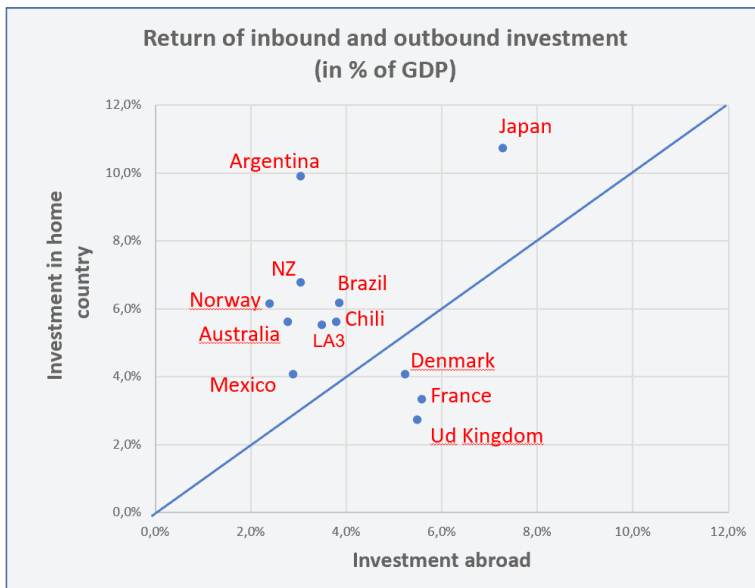
The dividend-yield, i.e., the cash flow in relation to the market value of the FDI position in equity is 4% in 2019, which is substantial. The IRR of total FDI in Chile is 12.9% in USD between 2009 and 2020 and 16.4% in CLP⁷. The figures are 6.1% in USD and 12.4% in CLP between 2014 and 2020 respectively. It shows a hefty profitability but that declines over the period. (These

7. Own author's calculations, available upon request.

figures should be taken with caution. Most of these foreign-owned companies are not listed, and their valuations result from calculations by BC's statistical services based on comparable companies.)

Enlarging the analysis to other countries (Figure 5), we see however that the situation of Chile is a fairly general case as per the ratio of income to GDP. The countries where foreign income exceeds the income of foreigners in the country are the most advanced countries, with the notable exception of Japan. Chile is on the format of AL3 and not far from EX3.

Figure 5. Return of inbound (in home country) and outbound (abroad) direct investment



Computing the total rate of return

Table 7 summarizes the TRR (including capital gains in the case of equities) of Chile's capital positions vis-à-vis the outside world. It shows the clear superiority, over the 2006-20 period, in terms of returns, of FDI in Chile over those made from Chile abroad: 15.6% for investments in Chile in USD and 18.3% in CLP, compared with an average of 5.9% for outbound investments. Building on that, OECD (2016) shows

that the profitability of foreign firms in Chile is substantially higher than their Chilean counterpart firms in the same sector, due to their generally higher size, better technology and capacity to attract the most skilled personnel. Profitability is not a problem *per se*, but the study also shows that such investments have no high spillovers on the economy and that, referring to Schwellnus (2010), record higher mark-ups that

Chilean firms. Indeed, foreign subsidiaries in Chile are profitable. An example of it could be the AFPs, which are overwhelmingly foreign-owned, and which posted a 30.3% return on equity after goodwill in 2019, and a net profit of \$0.6 bn, quite a feat in a service business with very low specific risk.

The opposite is true for portfolio investments: investing outside Chile, which is what pension funds are doing at more than 50% today, yields a 6.2% TRR, whereas the rate would stand at 3.6% in Chile (and 6% measured in CLP), under the same period⁸.

Taking a wholesome view, balance of payments data indicate that direct and portfolio foreign investments in Chile have together historically yielded a 13,2 percent return in USD terms (15,9 percent in CLP), whereas Chilean investment abroad a 5,9 percent.

Table 7. Total return outbound and inbound, in USD and in CLP

Chile Yields on investments 2006-2020	Net investments	Outside Chile		Inside Chile		
	Stock as of 2019 in USDm	Stock as of 2019 in USDm	Yield in USD in %	Stock as of 2019 in USDm	Yield in USD in %	Yield in CLP in %
Direct investments						
Equity	-128 476	143 622	5,9%	272 097	15,6%	18,3%
Debt Instruments	-92 574	122 686	6,9%	215 260	16,7%	19,5%
	-35 902	20 936	0,8%	56 837	3,4%	5,8%
Portfolio investments	78 209	183 726	6,2%	105 517	3,6%	6,0%
Equity	120 703	144 051	6,8%	23 348	-1,9%	0,4%
Debt Instruments	-42 494	39 675	3,3%	82 170	5,5%	8,0%
Total Investments	-78 396	60 611	5,9%	139 007	13,2%	15,9%

Source: IMF, BC, author

The following three figures (6-a to c) show time series over the period: TRR of total FDI in Figure 6-a and, then broken down into equity and debt in the two following ones. Investment in Chile is almost always more profitable than investment in foreign countries

8. This calculation is based on balance of payments data, not on the statistics of the pension fund supervisor, due to their mere absence in the publicly available statistics..

from Chile, even if, as noted earlier, the profitability gap has gradually narrowed over the period largely due to the fall of the Chilean peso at the end of the period.

Figure 6-a. Yield on direct investment inbound and outbound

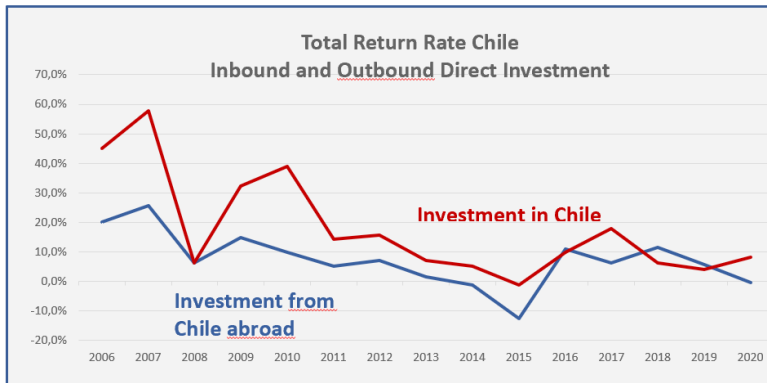


Figure 6-b. Yield on direct investment in equity inbound and outbound

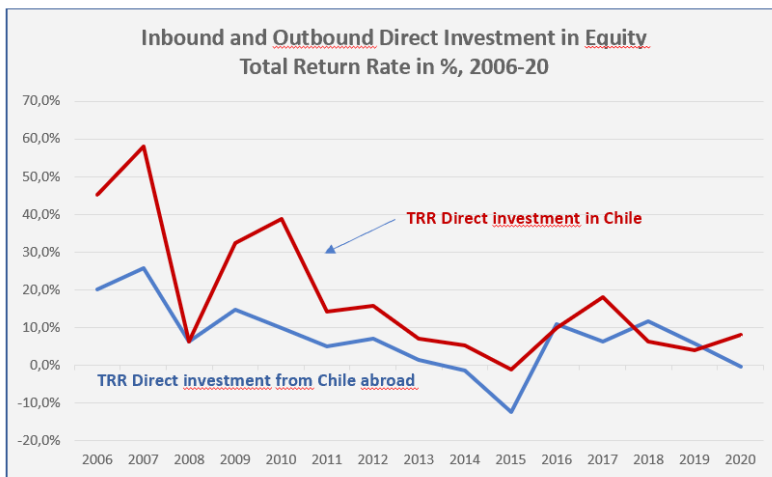
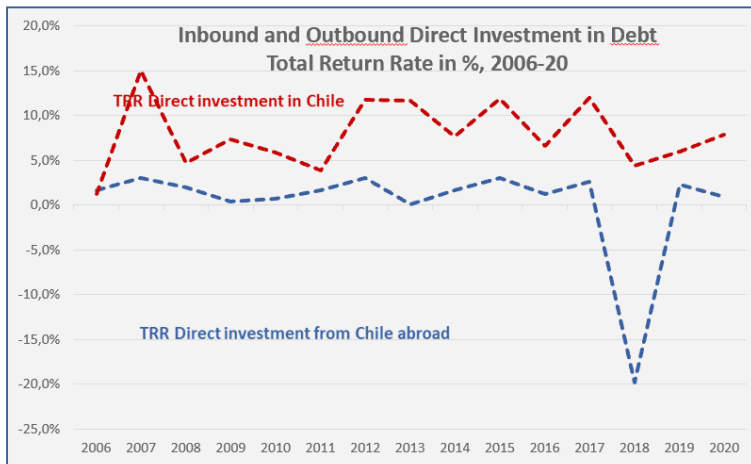


Figure 6-c. Yield on direct investment in debt, inbound and outbound



Two preliminary conclusions emerge: 1- It has been extremely profitable to invest in Chile through greenfield projects, concession agreements and M&A, 2- Chile's net financial positions represent an overall opportunity loss, in the sense that foreign-owned capital in Chile is substantially more profitable than Chilean-owned capital abroad. The leverage effect works in reverse. Abruptly said, Chile, due to its large exposure to foreign capital, is a sort of hedge fund, but working to the reverse: it borrows high and lends low. It contrasts highly with the situation of other countries, above all the US, and France to a lesser extent, where the leverage effect is positive, as shown by Gourinchas-Rey (2013) and Gourinchas (2019) among many authors. To mitigate this judgment, a large share of Chilean direct investment abroad is ultimately foreign-owned capital, as noted, but this fact does not impact the Chilean national income.

3. CHILE-NEW ZEALAND COMPARISON

New Zealand is often cited as a model for Chile. For example, Enade (2018) or Rivas (2019). Even if the first one is almost three times richer in GDP per capita (in current USD), the two countries share many similarities: both

are geographically "insular" and far from the world's major production centers, both are very open to the outside world, have similar export structures where raw materials, mining or agricultural dominate. They are both net importers of capital through FDI. The level of their GDPs is comparable. Both economies have been largely liberalized at about the same period (1984 on in NZ). González, Larraín y Perelló (2020), already cited, link the structure of New Zealand's foreign trade to its development model and conclude that the country's growth has been built largely on the promotion of exports as they stand and has not required greater sophistication in domestic production and reshuffling of the export structure. Based on the similarity with Chile, they argue that a trade development strategy for that country could "*primarily focus on promoting the export sector and not on diversification itself.*" This begs the question: is the financial structure as similar as the trade structure is?

Foreign direct investment is more profitable in Chile.

An immediate difference between the two countries is shown in Table 8: the profitability of foreign investment (direct and portfolio) is much higher in Chile than in New Zealand over the period, at 13.2 percent versus 8.0 percent respectively. This applies for rather similar

amounts of investment: 135% of GDP in 2019 for Chile, compared with 117% for New Zealand. On the other hand, the profitability of foreign investments abroad is of the same order of magnitude: 5.9% for Chile, 7.2% for New Zealand. Another way of looking at it is that profitability is homogeneous for capital inflows and outflows in New Zealand (8% and 7.2%), whereas, as we have seen above, there is a large gap in profitability (13,2% vs. 5,9%) to the detriment of Chilean resident entities. We have to dwell on this point some more.

Table 8. Total return on investment inbound and out-bound for Chile and NZ

Total Yield on Inv. Position 2006-20	Outbound		Inbound	
	Stock as of 2019 in % of GDP	Yield in USD in %	Stock as of 2019 in % of GDP	Yield in USD in %
Chile	117%	5,9%	135%	13,2%
New Zealand	65%	7,2%	115%	8,0%

Table 9 complements the table above by providing a two-pronged TRR comparison, direct vs. portfolio, and equity vs. debt. It should be read in conjunction with Table 7 above, which deals with Chile.

Table 9. Total return outbound and inbound, New Zealand

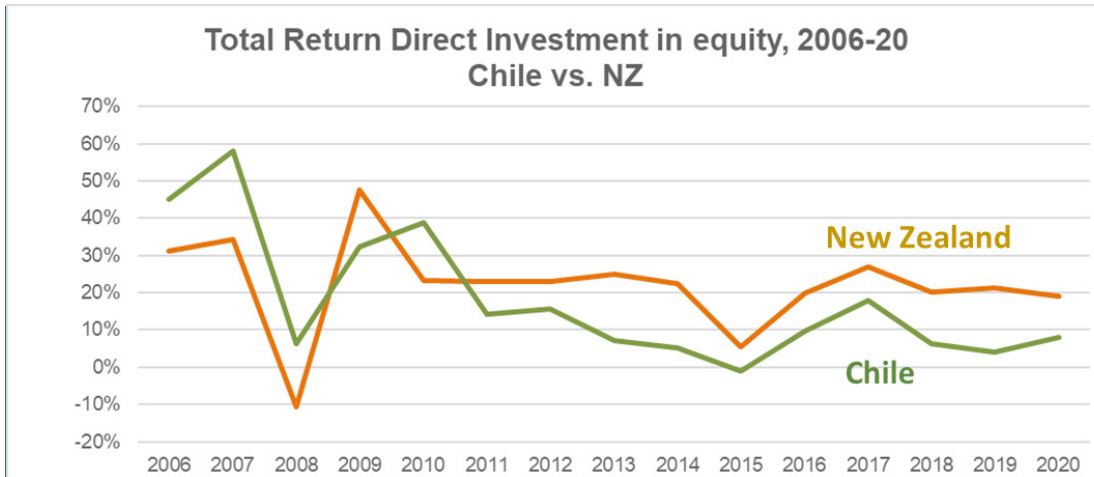
New Zealand Yields on investments 2006-2020	Net investments Stock as of 2019 in USDm	Outside New Zealand		Inside New Zealand	
		Stock as of 2019 in USDm	Yield in %	Stock as of 2019 in USDm	Yield in %
Direct investments	-64 541	22 599	4,7%	87 140	13,2%
Equity	-47 889	13 058	6,9%	60 947	21,5%
Debt Instruments	-16 653	9 541	1,8%	26 193	2,9%
Portfolio investments	-40 934	116 523	8,2%	157 457	4,0%
Equity	35 309	78 674	10,2%	43 365	4,8%
Debt Instruments	-76 243	37 849	3,8%	114 092	3,0%

Source: IMF, BC, author

It shows that the difference in profitability between New Zealand and Chile for direct inbound investments mostly stems from direct equity inbound investments.

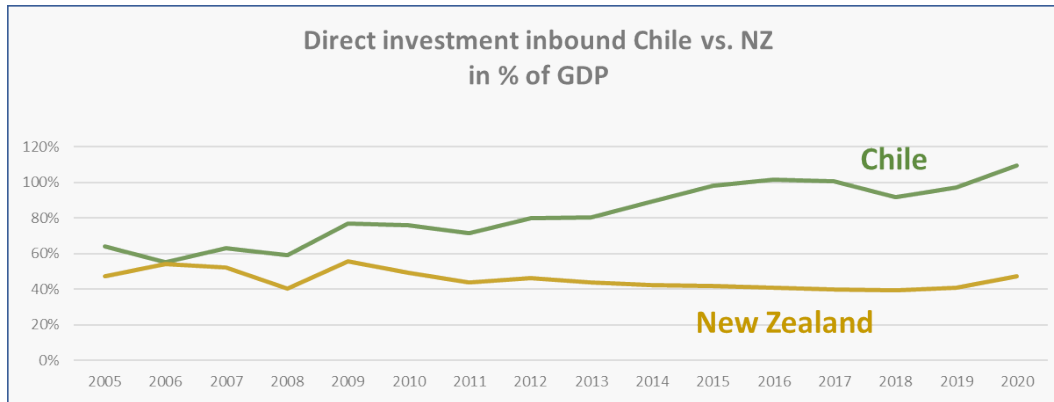
Figure 7 shows that the disadvantage has been structural since the year 2008.

Figure 7. Yield on direct inbound equity investment. Chile and New Zealand



This performance is all the more pronounced that the share of FDI in the country remained stable in the case of New Zealand, whereas it grew over most of the period in Chile (Figure 8). The proportion has barely bulged in New Zealand at some 45% of GDP, whilst, at the same level in 2006, it reaches 110% in 2020 in Chile. It remains to be analyzed whether this upward trend in Chile results from better performance of foreign-controlled sectors vis-à-vis the rest of the economy (and therefore better marked-to-market valuation) or through more money injected in the country. The slackening of new inbound flows as of late points to the first assumption. Once again, it has been very profitable to invest in Chile, begging for further analysis of these sources of profitability, be they above average growth or above average competitive profits.

Figure 8. Direct equity investment position. Chile and New Zealand

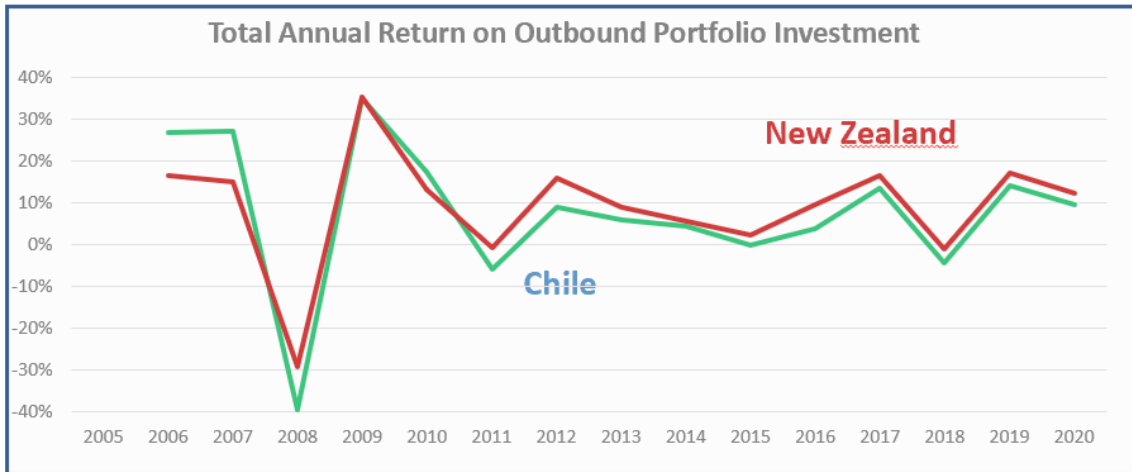


Financial investments

As noted, Chile exports significantly more capital than NZ under the form of portfolio investment (\$183 bn vs. \$116 bn) because of the importance of pension funds as a vehicle for household savings in Chile. New Zealand’s pension system is very different, with a still very small share of capital funds⁹. New Zealand makes smaller investments, but more profitable: 10.2% on average over the period 2006-20 in New Zealand, compared with 6.8% in Chile. Figure 9 provides a historical view, slightly distorted due to the swing occurred during the Great financial crisis of 2008.

9. The pension system in NZ is composed of two pillars. The first one, the New Zealand Superannuation (NZS) scheme is a public non contributory flat rate paid to all residents, at the age of 65, under some conditions of residency. It is viewed more as a safety net than a replacement of earnings. The second pillar is a contributory scheme to private pension funds, with a tax-deductible contribution rate is either 4% or 8% calculated on gross salary. As it was implemented only in 2007, the capitalized amount of NZ pension funds is still low. See OECD Pension at a Glance, 2021.

Figure 9. Annual yield on portfolio investment abroad.
Chile vs. NZ



A more asserted judgment may need a closer look on elements such as the type of asset management elected, the level of risk it accepts and the level of commissions charges by the foreign managers. Unfortunately, the publicly disclosed statistics of the Chilean Superintendency of Pensions do not provide disaggregation of performance between domestic and foreign investments.

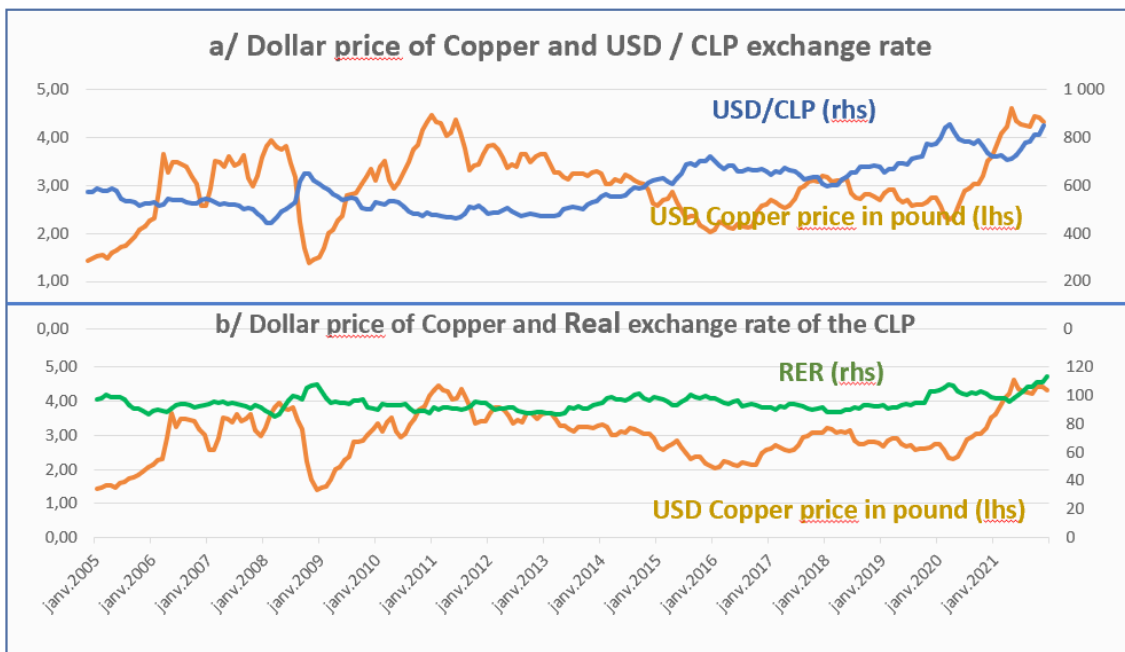
4. BY WAY OF TENTATIVE CONCLUSION

Alongside this purely descriptive picture of the financial external positions of Chile, we indulge into some more tentative considerations. Here they are.

1. Chile's financial position with the outside world is important and negatively geared, in the sense that the cost of financing abroad is higher than the return on funds that it invests abroad. The difference is quite significant.
2. A large portion of the equity return on FDI in Chile is divided out, adding a funding issue to the profitability picture. The current account balance of Chile has easily supported this cash-out in the past, due to

the country prime position in the export of copper, even though copper has had a diminishing impact over the years in the economy and its business cycle (De Gregorio-Labbé, 2011). An overall equilibrium in the long-term funding of the economy has resulted. Starting from 2019 and at least up to 2021.Q3 at the time of writing, it no longer does. This applies notwithstanding the spike of the copper dollar price, enhanced in terms of local purchasing power by the increase of the dollar. Indeed, the USD/CLP nominal exchange rate and the USD price of copper, which used to move in opposite directions (Figure 10-a), with a hefty correlation coefficient of -0.54 between jan. 2008 and June 2020, have departed from their ordinary course to moving in tandem in 2020-21. It's interesting to note (Figure 10-b) that the real exchange rate is significantly more stable and no longer shows a negative correlation with the copper price, a sign that the stabilization effect of floating exchange rate plus sterilization of the copper price via the balanced budget rule are reasonably effective. It is admittedly a weak test, and it would be better to correlate the real exchange rate with the non-copper non-oil terms of trade as in (2016, but it points to the same direction.

Figure 10. Price of Copper and USD/CLP nominal exchange rate



Shorter term, starting in 2020, this imbalance is explained by the surge in private demand due to the large hand-outs to the private sector created by the *retiros* and the government support plans, and by some outflow of hot money due to a more uncertain environment. The public budget now runs a substantial deficit, -7.6% in 2021, whose funding is mostly met through external indebtedness.

All this to instigate the somewhat ingenuous questioning: if ever there is financing abroad through portfolio investment and exposure from abroad through FDI, is there not a case for matching these two flows of funds? The more so since money going abroad yields far less than money coming inside. This is not to argue for a more autarkical mode of development, a sort of *Chilexit*, to refer to the British situation. This points to two items: the way the pension system is funded, and the way Chile politically addresses the financing of its industrial assets and their property rights.

The pension funds dilemma

3. As said, pension funds now invest (largely by force) the bulk of the collected savings outside Chile (up to 52% as at the last counting of stocks, more some on average in terms of flows over the past three years). From the point of view of existing and future pensioners, it is very clearly the optimal decision, as it has proven so over in terms of yields, at least for the households capable to invest in highly equity-levered funds, the A and B funds, due to their higher personal level of income and consequently their lesser risk aversion¹⁰. But two strong qualifications are in order. Firstly, such savings incur quite a large exchange rate risk. The peso may decrease, but it may also increase and therefore abet the performance of foreign securities. It has done so for instance from 2016 to mid-2018. Indeed, it is quite remarkable to see how the aggregated performance of non-domestic assets in pension funds is

dependent of the exchange rate. A brief calculation on the performance of AFP funds between 2014 and 2019 done out of balance of payments figures¹¹ shows that most of their hefty return of 90% over the period, i.e., 11,2% per year in CLP terms, is explained up to 42% by the USD/CLP appreciation and only to 34% by their intrinsic dollar return (Table 10). It is a sobering consideration to note that Chilean future pensioners as of late have been betting for more than half of their pension performance on the demise of the own national currency¹².

10. The mediocre to poor performance of the F and D funds is the other side of the coin.

11. However, the sell-out of funds, including foreign assets, to fund the *retiros* has played as a counteractif force against the fall of the peso. Again, such figures are not publicly available from SP's databases.

12. Up to a certain extent, it has a destabilizing effect: higher outflows of portfolio investments due to profitability considerations, trigger a downward pressure on the peso, which plays self-reinforcingly.

Table 10. Performance of Chilean pension funds on their foreign investments 2014-19

Pensions Funds in Chile, unit in billions	Amounts in USD	Exchange rate USD en CLP	Amounts in CLP
as at Jan. 2014	67,5	524	35 370
New investments	17,7		
Capital gains from prices and X-rates movements	5,0		
as of Dec. 2019	90,2	745	67 199
Growth factor 2019/2014	1,34X	1,42X	1,90X

Source: SP, BC, author's calculations

Secondly, if Chilean pension contributors are better off by investing their funds abroad, it is not necessarily so at a macroeconomic level. Here is a typical instance of a composition fallacy (mistaking the part as representing the whole). If the higher return for the pensioner is met through a loss of money by the government (because the central bank is forced to indebt itself abroad and therefore delivers less dividends to the government) or through opportunity losses for local investors who cannot access the type of profitability that foreign-owned assets deliver, there is no overall gain. The Chilean saver is also a Chilean taxpayer and a Chilean producer. A good example is met by Japan. Its pension system is mostly run, as in Chile, by a fully funded pension regime. And pension funds invest heavily in poorly remunerated sovereign bonds. It means a lower cost of funds for the government and therefore lower taxes for Japanese households.

4. Turning to the ‘supply side’ of the pension system in terms of available eligible assets, it may be agreed that there is a dearth of available domestic securities, creating an absorption problem. By force, the funds must invest abroad. But this consideration might lead to a different policy recommendation. Instead of ever increasing their foreign exposure, be it by yield arbitrage or by the mere growth of the funds, a cap

on such exposure may be mandated¹³. There are two ways to achieve such an objective.

5. The first method to implement the cap is by setting up a supplementary pillar in the form of a (fully funded) pay-as-you-go system (PAYG). Conceptually, a PAYG system grants non contractual yet enforceable claims on future labor incomes of the workforce and is perfectly sustainable under macroeconomic conditions that apply similarly to a capitalization system. If wages move in tandem with profits (as it does empirically and theoretically in a balanced-growth economy where profit and labor share of the GDP are constant), then the future labor claims are like claims on future profits, something which is at its turn very similar to equity claims on the economy, as the ones owned by a capitalization fund¹⁴. But, differing from investment funds, it is a claim on all firms, be they listed or not listed, and a claim only on domestic assets and not on foreign ones. In terms of idiosyncratic risks, there is a clear complementary of the two systems. With such a complement, a larger share of savings could be

13. As a matter of irony, the ‘retiros’, even though they debatably have been one of the worse economic policy errors (forced or non-forced) of the past few years, have worked to that effect.

14. If the rate of increase of the nominal wage bill equals the rate of return on pension investment funds, it can be showed that the financial performance of the two systems is the same, all other things equal. Indeed, Meunier (2021b) documents that the rate of increase of the aggregate wage bill of the economy between 2004 and 2019 was 8,7% when the return on pensions funds (out of commissions) was 9% on the same period.

available to, and in search of, investment opportunities in the country.

6. A second way to do the capping consists in an extension of the local assets potentially accessible by the pension funds. A policy recommendation could be that more foreign-owned industrial assets be listed on the stock market (à la Aguas Andinas) and therefore be absorbing more local savings. Alternatively, foreign groups may be incentivized to co-invest with local groups and require a local listing. New concessions, or concessions at their time of renewal, may be directed to a larger extent to local interests, for instance to governments sponsored management entities with the funding of pension funds. This also raises the policy issue of extending the list of eligible assets by pension funds, for instance non listed infrastructure assets¹⁵. This could be called the 'inwardization' of domestic finance.

7. Without impinging too much on industrial policy issues that are outside the scope of this paper, there is not enough domestic equity money injected in Chilean industrial assets, and notably assets in the utility and mining sectors. Three arguments have been raised against a more proactive industrial policy. The first one, put forth some twenty years ago, is that Chile lacked the human expertise to effectively run when the wave of concession or mining rights granting was launched, during the military regime and again at the start of the century. Some 20 years have passed, and the level of education and industrial expertise have dramatically improved over the period, so the argument no longer

15. It has been suggested (Meunier, 2021a) that pension funds invest in the highway system of Chile. The 'expertise' involved in running a highway is easily replicable. And a side political benefit may result by slogans of this sort: "When you pay the highway toll, you contribute to your retirement!", enhancing a joint popularity of the pension system and of the tolling.

To be noted that the Dutch pension fund APG acquired in 2020, in conjunction with the Spanish company Celeo Redes, the Chilean company Colbún Transmisión S.A., a major operator in electricity networks, which means that infrastructure asset are palatable ones for pension funds. Indeed, the five-year dollar return on the S&P Global infrastructure index was 7.07% at mid-2021.

applies¹⁶. The second one is a matter of fair competition principle, according to which the best bidder passes the post, be it a foreign or a local group. The large foreign groups have undoubtedly enough expertise and economies of scale in their field to be efficient competitors. But they have also a strong expertise in negotiating square contracts that may not always prove to be to the best interest of the country. Finally, governance issues have been raised, as per the risk of a weakening of competitive forces in case a local bias is introduced in the granting of concessions. All these qualms are certainly respectable, but the issues raised can be addressed through specific institutional designs. There is a strong case to be made for an 'inwardization' of the savings of the Chilean economy.

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1. Si el artículo es acogido por el editor, este designará a los pares que lo evaluarán, sobre la base de una doble lectura anónima. La temática que aborda el manuscrito, será evaluada según los siguientes criterios:

- Respecto al tema: originalidad, claridad del planteamiento, interés científico.
- Rigor académico: postulado de una idea central, fundamentación en un cuerpo teórico, correcta estructuración, entre otros.
- Aporte al conocimiento: contribución a nuevos saberes, críticas, análisis, proposiciones.
- Aspectos formales: correcta presentación del manuscrito de acuerdo a las normativas editoriales de la revista.

Véase pauta evaluación en sitio web de la revista.

2. Los evaluadores decidirán si un trabajo cumple o no con los criterios generales mencionados en el punto anterior, e informarán al Editor (en caso de existir) observaciones para el mejoramiento del manuscrito final.

3. El editor informará al autor sobre la decisión de publicar, publicar condicionado a cambios o rechazar el artículo, entregando las observaciones en caso de ser necesario para la preparación definitiva.

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5. Aquellos autores cuyos artículos sean publicados recibirán tres ejemplares de la respectiva Revista.

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En caso que el editor considere que el artículo debe ser aceptado *condicionado a cambios*, enviará las sugerencias correspondientes al autor, en el mismo plazo señalado. El autor deberá devolver al Editor, en un plazo no mayor a 15 días, el artículo revisado aceptando/explicando/rechazando, las correcciones correspondientes. Si el artículo es aceptado sin condiciones, será enviado a los pares evaluadores y continuará el proceso que a continuación se describe.

El editor, en una segunda etapa y al igual que para los artículos aceptados en primera instancia (sin sugerencias editoriales), enviará el artículo a pares

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Finalmente, el artículo pasará a la etapa de revisión de estilo la cual es realizada por profesionales de la Editorial UTEM, así como también pasará a revisión del título, resumen y palabras claves, quienes devolverán –en caso de existir– sugerencias o cambios a lo presentado. Estas nuevas sugerencias de estilo, que se enfocan principalmente en cuestiones como: revisiones semánticas, tiempos verbales, exigencias de citación y apego a las normas, serán compartidas con el autor para su conformidad. Una vez que se ha revisado aceptado/rechazado, el artículo pasa a etapa de diseño y, finalmente, impresión y publicación.

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Notas al pie de página: las notas al pie de página irán numeradas consecutivas.

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